

THE CENTRAL AMERICAN COMMON MARKET

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## INTRODUCTION

Economic integration has become the "magic remedy" for all external and internal economic problems facing national economies. This attitude has probably been due to the apparent success of the European Economic Community in recent years. Following this lead, many countries are now discussing various types of custom union arrangements and some have made definite attempts.

Integration has a special appeal to the underdeveloped countries of the world which have failed to bring about an acceptable rate of growth by internal economic policies. It is hoped that increased trade, through a custom union approach, will accelerate growth to an ever increasing level. The purpose of this paper will be to study one such attempt: the Central American Integration Program. In fulfilling this purpose, the program itself will be evaluated with some special attention to its probable success or failure.

### The Countries

In discussions to follow, the countries of Guatemala, El Salvador, Honduras, and Nicaragua will be considered as integration participants,<sup>1</sup> Costa Rica as an outside member with special entrance privileges,<sup>2</sup> and Panama

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<sup>1</sup>These are the four countries that have actively participated in negotiations and have signed the treaties formed up to this point.

<sup>2</sup>Although Costa Rica has participated in the discussion and has signed the majority of the necessary treaties, it has not as yet signed the General Treaty of Central American Economic Integration. This stems partly from the highly protective views of the influential business class of Costa Rica and

considered as being a permanent outsider.<sup>3</sup> It may also be noted that the members of the Central American Integration Program are also taking part in the Latin American Integration Program negotiations which are not covered in this paper.

Of the five countries involved, Costa Rica and Guatemala share the lead as far as the current state of development goes, with El Salvador taking a close second. This may be demonstrated by looking at the comparative Gross National Product figures of the countries, as follows:

Table 1. Gross National Products of the Central American Common Market countries (in millions of United States 1957 dollars).

Country	GNP
Costa Rica	2,120.0
Guatemala	657.2
El Salvador	490.7
Honduras	343.4
Nicaragua	240.0

Source: Yearbook of National Accounts Statistics, Vol. XVII, Statistical Office of the United Nations, Department of Economic and Social Affairs, 1959.

Looking at the per capita income figures will show that the Gross National Product figures are attested to somewhat:

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their opposition to competition from the other members. Special provisions have been written into the General Treaty for Costa Rica's entrance as is described in sections to follow.

<sup>3</sup>Panama has not entered into the negotiations, nor has it signed any of the treaties.

Table 2. Per capita income figures of the Central American Common Market countries.

Country	Income
Costa Rica	770.0
Nicaragua	185.0
Honduras	163.0
Guatemala	162.0
El Salvador	207.0

Source: Yearbook of National Accounts Statistics, Vol. XVII, Statistical Office of the United Nations, Department of Economic and Social Affairs, 1959.

It appears that these figures demonstrate a higher GNP in the more populated countries of Costa Rica, Guatemala and El Salvador, but that, with the exception of Costa Rica, the smaller countries enjoy a slightly higher rate of per capita well being. This may prove significant when discussing certain problems that integration may pose on further development of the member countries.

The respective populations of the countries and the rate of population growth over the last decade are:

Table 3. Population and population growth rates of the Central American Common Market countries in July 1959 (in thousands).

Country	Population	Rate of Increase
Costa Rica	1,126	4.1%
El Salvador	2,520	3.5%
Guatemala	3,652	3.0%
Honduras	1,887	3.3%
Nicaragua	<u>1,424</u>	3.4%
Total	10,609	

Source: Yearbook of National Accounts Statistics, Vol. XIX, Statistical Office of the United Nations, Department of Economic and Social Affairs, 1960.



Finally, the index numbers below show the general proportions of the products and industries that are located in each country:

Table 4. Index of primary production activities performed by the Central American Common Market countries.\*

Industry	Guatemala	El Salvador	Nicaragua	Honduras
Food	14.6	12.5	34.0	26.0
Beverage	12.6	1.5	13.0	21.0
Tobacco	9.2	1.0	14.6	8.0
Textiles	33.0	48.0	15.0	10.0
Soap	17.5			
Lumber and fur		15.0		17.0
Metal pro- duction		7.5		2.4

Source: Yearbook of National Accounts Statistics, Vol. XIX, Statistical Office of the United Nations, Department of Economic and Social Affairs, 1960.

\*Costa Rica's figures available.

The discussion will now turn to the program itself and its probable influence on the member countries.

In this respect, one section of this paper will deal with the expectations and problems that have arisen out of the organization of the Common Market, one section will deal with the treaties that were negotiated in the formation of the Market, and one section will deal briefly with the probability of success or failure of the integration program.

## EXPECTATIONS AND PROBLEMS

## Background

The primary goal of establishing a common market is that of solving many of the economic and social problems of the Central American states via economic reforms. Parts of these reforms are geared towards expanded productive activity through increased trade, competition, technology, and investment. Eventually, it is hoped, all activities of the Central American economies are to be consolidated into a broad scheme of integration. For the present, however, only a limited number of activities are to be included.

There are many provisions for social, as well as economic reforms, although the two cannot be entirely separated. Eventually, political union may become the goal of the program, and with this union, broad social programs may be expected to take the major portion of the market's attempts. For the immediate future, most social reforms center around a desire to increase the skills of the various countries' labor populations via the educational process.<sup>4</sup>

As will be seen in this section, many of the expectations are, for the present, only blind wishes. The hopes that may be realized have to overcome centuries of growing poverty and ignorance if they are to be successful.

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<sup>4</sup>Many of the expectations have come out of various meetings held under the auspices of the Organization of Central American States. During these meetings, the idea of social reform played a key role. A more complete discussion of these discussions may be found in William R. Gigax's article, "The Central American Common Market," Inter-American Economic Affairs, Vol. XVI, Autumn 1962, pp. 59-77.

The technical expectations that should be realized through no more than the organization's implementation will be discussed in the following section of this paper by looking at the treaties negotiated to create the market. Attention will now be paid to some of the hopes that are not expressed in the written treaties, but that obviously follow any integration attempt. The problems that will have to be met before these expectations will have a chance of becoming reality will then be discussed.

#### Expectations

Efficiency.--In just about any standard text that discusses economic integration or the "theory of the firm," a reader will find some attention paid to the economies of scale that may be present in certain industries experiencing decreasing costs. This principle is one of the factors that has influenced the joining of many separate markets into a larger market, and it is probably the major factor influencing the Central American Integration Program.

Briefly, this principle states that an industry operating under conditions of decreasing costs will be able to produce more efficiently as the scale of output increases. With regard to the integration program, the scale of output will be permitted to increase if there is a sufficient market available to absorb this output. Each of the Central American markets taken by themselves would not permit large scale enterprises for the most part, but taken together, it is hoped that the size of the market will be large enough to allow economies of scale to set in.<sup>5</sup>

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<sup>5</sup>Graphically, we may represent the economies of scale principle by using an average per unit cost curve with scale of plant represented on the horizontal axis and per unit cost represented along the vertical axis as in

Along these same lines, it is further hoped that the integration program will provide for greater efficiency through increased competition within certain industries. This expectation has a strong basis in fact since, ". . . resources are devoted to similar industries in each country . . . (therefore) . . . a substantial amount of competition is indicated."<sup>6</sup> This increased competition will serve the purpose of driving previously inefficient industries towards improved methods of production in order to remain in a favorable competitive position. It will also tend to drive the traditionally inefficient producer out of the market altogether and thereby release these resources towards the more efficient production processes. Again, more goods at less cost will be the result of integration.

Finally, efficiency is expected to be increased through cooperation among the various governments in technological research endeavors. One of the major problems confronting the Central American governments individually is their lack of inventive capabilities. This may be due to the slowness of recognition for inventions in the form of new investment. It is hoped that

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the figure below. Anywhere along the curve between points A and B, the firm would experience lower costs by expanding its scale of plant. After point B has been reached, the plant will have become too large and diseconomies would set in.

It is hoped that an expanded market, through integration, may allow firms meeting these conditions to expand their scale of plant sufficiently to approach point B on the cost curve. At B, the optimum efficiency point will have been reached and there would then be more goods available at a lower price than before integration.

<sup>6</sup>Charles E. Slatey, "Central American Economic Integration," The Southern Economic Journal, Vol. XXIX, October 1962, p. 93.

investment will be promoted through integration and that this may bring about an increased demand for new innovations.

New investment.--Integration theory has mentioned the probability of foreign capital entering a common market area in order to avoid the external tariff imposed by the member countries. This is the great hope of the Central American Common Market countries who have long been starved for new capital investment.

According to the theory, capital tends to flow behind trade barriers, such as a tariff, in order to avoid the penalty imposed by the country levying the tariff. This capital will probably take the form of new investment in the foreign country. Before this investment will take place, however, there must be a market that is sufficient in size to handle the expanded production. The Common Market has both the tariff and the size to satisfy the conditions mentioned above. Domestic investment that had to search for foreign markets prior to the Common Market may also be induced to remain at home through the newly expanded market conditions.

When speaking of new investment, certain qualifications must be made concerning the specific types of industry that may be induced to enter the area. As will be discussed below, even with their markets combined, the Central American countries will still have a relatively small market. Because of this, and the lack of skilled labor in the market area, only light industry will be able to show any success, especially in the short run.

#### Problems

Market size.--As defined in most economic texts, market size refers to the size in relation to the number of consumers willing and able to pur-

chase the country's output, not to geographic size. Using this concept as a base, there may be a potential problem concerning market size, even after complete integration takes place.

As was shown in Table 3, after integration there will only be slightly more than ten million persons in the total market. Couple this with an average per capita income figure that is only slightly higher than three-hundred fifty dollars per year, and there remains but a small market for Central American goods.

What does this mean to the expectations arising out of integration? Simply, it means that the major factor that has discouraged efficiency and investment in the past may not be taken care of with the joining of the nations into a single market. If this notion is correct, the needed investment that one would hope to see come into the market may not have any more incentive than before, which would put the Central American countries back to where they started.

Closely linked to the above obstacle is the maldistribution of wealth that has long characterized almost all of Latin America. The national income figures mentioned in Table 2 are not only low in comparison to other countries the same size, but they are generally distributed to a small number of wealthy individuals, while the masses are merely earning an existence level of income. According to Charles Slately,

The skewed distribution of income, supporting a substantial wealthy class, is notorious in Central America; so is their preferences for investment in land, in securities, and in sight deposits.<sup>7</sup>

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<sup>7</sup>Ibid., p. 94.

This further limits the market size and it may be expected to impair the growth potential of the area.

Even though regional development under a Common Market would have to be considered superior to some sort of national development guarded by high tariff and quota walls, it may not be wise to expect growth to be a sudden result of the integration attempt, since the ten million people in Central America, given the uneven distribution of wealth, do not represent a large market by any standard.

Agriculture.--First of all, it may be worth pointing out that the majority of these persons engaged in production in Central America are engaged in farming activities. Indeed, the great bulk of the Gross National Product figures presented in Table 4 comes from some type of farming activity. We may infer from this statement that any inefficiency in the farm sector will send out strong shock waves to all other sectors with regard to growth or prosperity.

According to William Gigax, who has spent some time looking at the Central American economies and their problems, the average farm in Central American countries is less than twenty acres in size, and they are generally run by peasant Indians who are, for the most part, inefficient due to a general lack of education in the area of farming skills. What is more, the capital equipment that is generally found on the Central American farm may consist of no more than a hand plow, a rake, and/or some primitive digging equipment. In other words,

. . . Productivity is low per worker and per unit of land in Central America. Until agriculture is conducted on a much more efficient basis, there will be no considerable purchasing power to expend on manufactured goods . . .<sup>8</sup>

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<sup>8</sup>Gigax, op. cit., p. 72.

### Conclusion

The lack of skilled workers, of any previous capital accumulation, of efficient farms or farming methods, and of a sufficient market size, all pose great obstacles to the success of a Central American Common Market.

Even if the countries can successfully accomplish their major goals of inducing small scale (light) industry to enter the market, of nationalizing existing industries or inducing them by some other means to increase their efficiency, of establishing freer more effective competition, of being better able to bargain with foreign nations from a position of collective strength, and of establishing more export industries, there will still remain many of the problems mentioned above. In all probability, the education of a skilled labor force and the combining of small farms into larger corporate types of farms will prove to be the prerequisite to establishing the major goals listed above.

Further, there are probably five criteria which must be met before even the beginnings of progress will be felt:

1. The trade barriers established by the countries against the outside world should not be too restrictive. In fact, they should be no higher than the individual barriers that were in effect before the market was formed.
2. The market cannot be dominated by any one country.
3. Economic policies need to closely coincide with one another as well as the respective wage-price structures.
4. State ownership, cartels, and monopolies need to be eliminated in each of the countries in order for the beneficial effects of competition to take place.



5. Transportation facilities and entrepreneur attitudes need to be favorable to the expected increase in trade volume.<sup>9</sup>

Although this has been but a brief survey of the expectations and problems coming out of the Common Market Program, they serve to give a background to the discussion of the various treaties to follow. It is well to remember that the integration program promises much, but that it will probably not be able to serve as a cure-all for Central American economic problems.

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<sup>9</sup>Slatey, op. cit.

## THE ORGANIZATION OF THE CENTRAL AMERICAN INTEGRATION PROGRAM

Five treaties have played the dominant role in establishing the Central American Common Market, four of which are signed by all of the Central American countries and one that Costa Rica has yet to sign. One important feature of all of these treaties is the "escape clauses" which allow the countries to pull out of the market within certain specified time periods. Although these clauses weaken the organization's stability, they demonstrate the reluctance of the various governments to give up their sovereign powers. This reluctance is nothing new. In all previous attempts at integration the fears of the ruling class have eventually led to collapse.

The idea of integration in Central America is not a new one by any means. Since the end of Spanish domination of the Central American States there have been many attempts to join into agreements bringing about union of the states in question.<sup>10</sup> Certainly the most recent attempt is less ambitious than its predecessors in that, for the first time, complete political as well as economic union is not an expressed goal of the countries. Although economics now underlies the Integration Program, the political aspect is not to be completely set aside. The ministers of the various economies have already begun negotiations and speculation into the idea of an United Central

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<sup>10</sup>These treaties include the Provincias Unidas del Centro de America in 1824; the Estado Unidas de Centro-America in 1898; and the Federacion de Centro-America in 1921. All were doomed to failure because of the rivalries among the ruling classes of the various states. For a more complete discussion of these early treaties see Warren R. Harden, Central American Economic Integration (Indiana University Press, 1965).

America in every sense of the word. In 1954, for example, Rafael Meza Ayan of El Salvador said:

It is our golden dream to reconstruct Central America into one nation. All the meetings we have had recently on economic cooperation will probably lead us to that.<sup>11</sup>

Multilateral Treaty on Free Trade and Central  
American Economic Integration

The first of the major treaties to be negotiated and signed into effect, hereafter to be referred to as the Multilateral Treaty, was originated under the guidance of the Permanent Secretariate and the Economic Commission for Latin America of the United Nations. The program leading to eventual integration was initiated in 1952, at which time trade between the five countries amounted to only 10.3 million dollars representing 3.2% of their total exports.

Until the signing of the Multilateral Treaty, the program consisted of a series of so-called miniature agreements negotiated by each country separately granting tariff advantages on specific commodities. This soon proved to be a slow and tedious process. During the first six years of operation, trade actually diminished, until by 1957 only 2.7% of the total exports were internally traded. Clearly the stage was set for more progressive action if any semblance of a free trade market area were to exist. To this end, the job was presented to the Central American Trade Sub-Committee of the United Nations which was made up of advisory personnel plus the ministers of economic affairs representing the various countries.

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<sup>11</sup>The New York Times, October 2, 1954, p. 4.

There were four responsibilities given this committee, including:

1. To draw up uniform trade and tariff nomenclature for the five countries. This was a crucial task since one of the early recognized difficulties in forming the union was that of different policies under different labels enacted and executed by the individual nations. Certain definitions and preliminary ground work had to be enacted concerning these problems before any universal treaty could be written.

2. To draw up uniform definitions, policies, etc., to be used in evaluating the various trade commodities. This had obvious advantages plus the preventive aspect against hidden tariff changes through different value standards.

3. To study the policies of the individual governments that may affect trade adversely and to analyze these policies completely.

4. To formulate recommendations based on the above studies.<sup>12</sup>

Out of these meetings came the Multilateral Treaty signed by representatives of Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica.

General goals.--This section expresses desire of the countries to form a customs union within a ten year period. To this end, two hundred goods were to be immediately exempt from any customs duties as specified in Annex A to the treaty, and the remaining goods were to be traded duty free within a ten-year period. Furthermore, the goods that were not mentioned for free trade are to be traded under a "most-favored-nation" arrangement between the contracting parties.

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<sup>12</sup>A more complete discussion of the above responsibilities of the sub-committee may be found in: "Central American Economic Integration Programme," Economic Bulletin for Latin America, United Nations, Vol. IV, pp. 33-48.

The Central American Trade Commission was then given the duty of preparing a recommended schedule of tariffs to be imposed jointly by the contracting nations against the rest of the world which is another major step towards a true common market. Contradicting customs agreements with outside nations were to be held in violation of the treaty subject to enforcement by the Trade Commission.<sup>13</sup>

Finally the central banks of the contracting nations were to work in close harmony in order to prevent currency speculation and other measures that affect rates of exchange and currency convertibility. If serious balance of trade difficulties occurred in any of the member states, the Trade Commission had the power to originate investigations in order to determine cause and to make recommendations.<sup>14</sup>

Taxes.--Any internal taxes, quota restrictions, or other restrictive programs against the products of the member states that are not imposed on products imported from foreign nations are to be prohibited. This includes goods that are not listed in Annex A of the treaty as well as those that are included. Further, no unfair competition via subsidy, state ownership, etc., is to be enacted against firms of one contracting state by another.<sup>15</sup>

Free transit.--There is to be free transit privileges granted to carriers engaged in inter-member commodity deliveries. This provision allows inspection and quotas only when security, public health, or police control are involved.<sup>16</sup>

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<sup>13</sup>Multilateral Treaty on Free Trade and Central American Economic Integration, Tegucigalpa, June 10, 1958, Articles 1 through 5.

<sup>14</sup>Ibid., Article 9.    <sup>15</sup>Ibid., Article 10.    <sup>16</sup>Ibid., Article 10.

Competition.--Free competition is to be promoted among the member countries so that any method allowing products to enter the borders of another member, at prices lower than competition dictates, is to be subject to restrictive controls pending a decision by the Trade Commission as to further action.

Transportation networks were to be extended through governmental cooperation with economic development as the ultimate goal. All foreign investments were to be accorded free entrance and fair treatment, e.g., control by the owners, etc., by the contracting states.<sup>17</sup>

Central American Trade Commission.--There is a provision for the Central American Trade Commission stipulating that each member country may send one voting member to the commission meetings. Its specific duties are: (1) To make proposals to the members concerning the extension or improvement of the system; (2) to propose solutions to problems that may arise between member countries; (3) to standardize custom tariffs, establish a fiscal system for articles under state monopoly, help make agreements to avoid double taxation in the case of direct taxation, encourage better inter-state transportation systems, and to introduce and use the metric system of weights and measures; and (4) to collect statistical information useful in the fulfillment of free trade between the countries.<sup>18</sup>

Final conclusions.--There is a provision for an arbitration tribunal consisting of five supreme court justices, one from each member country, which will arbitrate any unsolved dispute between member countries and is to render a decision which will be considered as final and binding. The decision will

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<sup>17</sup>Ibid., Articles 11 through 17.      <sup>18</sup>Ibid., Articles 18 through 20.

be made with at least a three to two vote. Also there is here a provision for the expiration of the treaty every ten years, renewable by re-ratification by any three of the member nations. Six months prior to this time, any country may remove itself from the market by notification. This is one of the escape clauses. If less than three countries are remaining after the ten-year period, the Common Market will be considered dissolved.

Finally, the countries are to grant the rights, duties, and status of citizenship to all citizens from other member countries. This implies that complete labor mobility among the nations is to be allowed. Under this same heading, the countries are to set up separate regimes for tariff policies that will be instituted against third countries.<sup>19</sup>

#### Annex A

Annex A of the Multilateral Treaty lists both those products which are to be traded duty free and those that have tariffs assigned to them. Within ten years all of the products in this annex are to be traded completely free or at a greatly reduced charge. Any quota restrictions that were in force prior to the signing of the treaty may still be enforced, but the goods that are allowed to enter under the restrictions are to be free from all further duties, and member countries have first priority over foreign goods with respect to quota fulfillment.<sup>20</sup>

As was mentioned before, one of the duties of the Central American Trade Sub-Committee was that of establishing a standard nomenclature regarding

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<sup>19</sup> Ibid., Articles 21 through 28.

<sup>20</sup> Annex A, Multilateral Treaty on Free Trade and Central American Economic Integration, June 10, 1958.

tariff and trade. Out of this committee came the Standard Central American Tariff Nomenclature (SCATN) of group items (represented by three digits), individual items (five digits), or sub-items (seven digits). Annex A of the treaty uses this nomenclature system when listing the traded products.<sup>21</sup> As was mentioned above, all products not mentioned under the nomenclature or in Annex A were to be traded under a most-favored-nation clause.

The Annex form then lists those products to be included in free trade and the conditions of tariff reduction to be included over the first ten years of the treaty. It is of some interest to note that the tariff reduction rates are listed under pairs of countries rather than for the market as a whole; e.g., El Salvador and Nicaragua agree to trade tomato and vegetable juices freely at the end of the sixth year, whereas fruit juices as a separate category are not even included in the regimes of Honduras and Nicaragua.

Finally, all goods that are not included specifically within the Annex are to be traded at equal rates of tariff between all members. These rates will be worked out in protocol meetings between the various contracting states. If a tariff is in force at the time of the treaty's enactment, and if the negotiations cannot find a suitable equalized tariff, then the lowest of all tariffs covering that product will be accepted as the new standard tariff.

#### Annex B

This section outlines the customs form and procedures that will be used when a commodity passes from one country to another. It includes the

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<sup>21</sup>Ibid.



proper method of marking the transported package, the exit and entry procedures, and the customs form to be used.<sup>22</sup>

The customs form includes such information as the place of origin, the exporter, the importer, and a general description of the product involved. It is to be used as both a certificate for forwarding the product and as a certificate of origin.

#### Agreement on the Regime for Central American Integration Industries

A major concept that was to be included in the master plan for final economic union, called the integrated industries scheme, was signed into effect after much debate among the five countries. Certainly the integrated industry was a large step in the direction of eventual industrial development within the common market nations, but the concept soon ran into great difficulty. Before discussing the treaty itself, it may be well to briefly explain the concept of the integrated industry and its probable future in the Economic Union.

The objectives of the integrated industry concept were:

1. To establish a favorable climate for industries that need immediate and free access to the entire market in order to operate on an efficient scale. This objective is similar to that of the infant industry argument of Alexander Hamilton. It implies that an industry experiences decreasing costs over some range of production and that this industry can reach this decreased cost with some initial capital expenditure. If these requirements are met,

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<sup>22</sup> Annex B, Multilateral Treaty on Free Trade and Central American Economic Integration, June 10, 1958.

the industry is encouraged to build at the lowest cost point and to operate there from its conception. This concept is restricted to light industry requiring a larger market than any of the member countries could provide if taken separately.

2. To promote the rational use of natural resources. This objective covers a wide range of possible topics as might well be expected. Primarily, it is an attempt to allocate the resources of the area to those industries that are most efficient in terms of cost and market potential.

3. To insure that industrial development, in terms of the distribution of these favored industries among the various countries, is made possible for all member countries. This is provided for in the treaty in some detail, so further discussion of this third objective will be deferred until the treaty itself is discussed.

As an over-all objective, putting the above three points into one, the integrated industry plan is an attempt to overcome some of the limitations of underdevelopment in the countries involved, e.g., highly limited resources, limited market size, and limited industry expansion possibilities.<sup>23</sup>

These objectives, and the treaty that attempts to implement them, cannot be taken too seriously at this time. Although the original treaty was very specific in its formulation, it was soon watered down through continual compromise into what is now a very ineffective, idealistic document. It has been included here to demonstrate the principle involved in its creation and to demonstrate its potential as a future concept of integration.

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<sup>23</sup>James D. Cochrane, "The Integrated Industries Scheme," Inter-American Economic Affairs, Vol. 19, Autumn 1965, p. 63.

Describing the treaty in general, it provides for:

1. The creation of a Central American Industrial Integration Commission which will have a variety of duties, foremost of which will be market feasibility studies of the conditions within the various countries with the establishment of integrated industries in mind. After making these studies, recommendations will be made to the various countries regarding the possibility of establishing the industry. It is also to settle any dispute between the countries regarding the integrated industry program. In the event of an unsettled dispute, the tribunal mentioned in the Multilateral Treaty will decide the case. All commission decisions are unanimous.

The commission is to consist of a representative from each country and is to meet often enough to fulfill its duties or upon the request of any member country.<sup>24</sup>

2. The plants in question are to receive incentives from the countries participating in the agreement and are to receive immediate free trade benefits from all member countries. These incentives are not explicitly listed and are left to the recommendations of the commission.<sup>25</sup>

3. Every country is to receive at least one integrated industry before any country has received two. The placement of any particular industry in question is to be decided by the commission provided for in the treaty. After every country has received at least one integrated industry, there is no specific platform dictated for the placing of future industries.<sup>26</sup>

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<sup>24</sup> Agreement on the Regime for Central American Integration Industries, Tegucigalpa, June 10, 1958, Articles 8 through 10.

<sup>25</sup> Ibid., Articles 1, 2 and 4.

<sup>26</sup> Ibid., Article 11.

4. Any industry that is already formed within the market that qualifies for integrated industry status is to receive a ten per cent reduction in tariffs per year for ten years, unless otherwise specified by the member countries on the recommendations of the commission. Further, if any new industry enters the market that produces a comparable or substitute product in competition with the integrated industry, that new plant is to receive comparable benefits in order to allow for effective competition among these industries. Any foreign manufacturer that produces comparable or substitute products for imports is to receive tariffs against that product, as determined by the member countries in a separate agreement.<sup>27</sup>

5. The treaty is to be in effect for a period of twenty years and is renewable for ten-year periods following expiration. Any country may renounce the treaty by giving two years notice. At this time the remaining countries are to get together to determine if the treaty will remain in force against them from that point on.<sup>28</sup>

It may be worth pointing out, in closing the discussion on integrated industries, that only two plants have been designated as such since the treaty was signed, those being a caustic soda and insecticides plant in Nicaragua and a tire and tube plant in Guatemala.<sup>29</sup>

#### Central American Agreement on the Equalization of Import Duties and Charges

This treaty, signed in September 1959, was meant to be an extension of the Multilateral Treaty to help carry out the objective of equalized tar-

<sup>27</sup>Ibid., Articles 5, 6 and 7.    <sup>28</sup>Ibid., Article 12.

<sup>29</sup>The tire and tube plant was already in operation when the treaty was signed. The insecticide plant was yet to be built in 1965. For a dis-

iffs. Most of the treaty is involved with the establishing of procedures for the eventual equalization of tariffs and duties against the rest of the world. With this in mind, we may now explore the treaty itself in more detail.

Tariff policies.--The member countries agree to equalize their tariffs over a five-year period with the needs and goals of the Common Market and the individual countries in mind. To this end, two schedules, A and B, are attached to the treaty with "A" listing those products subject to tariffs, and the charge that is to be made, and schedule "B" to include any exceptions that may be made to schedule A. There are five general classes of products to be considered under this treaty, and in the order of their priority for negotiations, they are listed as: (1) Products for which either immediate or progressive liberalization of trade has been provided for in the Multilateral Treaty. (2) Goods which are already being produced in the countries of Central America. (3) Any imported goods that will be a substitute for Central American goods, either immediately or in the near future. (4) Any intermediate product, including raw materials, containers, etc., that will be required for the manufacture or sale of Central American products mentioned above. (5) "Other goods."

The member countries further agree to charge only the tariff agreed upon by the members in schedules A and B, and that they will impose no other taxes in any form. Closely tied to this principle is the agreement that any countries having previously negotiated bilateral treaties with nonmember

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cussion of the problems in formulating the integrated industries plan, see Cochrane, op. cit., pp. 63-74.

countries are to renegotiate these treaties with the ultimate goal of dropping the special tariffs on imported goods.

Any good that was not included in the original schedules may be so included by negotiation and new protocol arrangements by the member countries.<sup>30</sup>

Finally, there is a provision for renegotiation on any single product or group of products that a member country desires to change. It further provides for progressive tariff equalization on any commodity that is not specifically listed in schedule A and those that are included in schedule B of the treaty. This eventual equalization is to cover only the products that cannot be immediately equalized for some reason or another; and the "interim period" is not to last for any lengthy time period.<sup>31</sup>

The Central American Trade Commission.--The Central American Trade Commission's membership is to consist of representatives appointed by the member states. They are to meet as often as is deemed necessary by the committee members or a member country. The rules for procedure in the performing of the committee's duties are to be enacted by unanimous vote within the committee's meetings.

The duties of the committee are: (1) To make recommendations to the member countries that will aid in the fulfillment of the common tariff goal; (2) to study any problem that may arise in the establishment of a common tariff; (3) to study and make recommendations concerning additions to the two schedules listed earlier in the treaty; (4) to study and coordinate

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<sup>30</sup> Central American Agreement on the Equalization of Import Duties and Charges, San Jose, Costa Rica, September 1, 1959, Articles 1 through 9.

<sup>31</sup> Ibid., Articles 12, 13 and 14.

attempts by member countries to sign bilateral treaties aimed at tariff equalization, (5) to oversee the uniformity and application of the Standard Central American Tariff Nomenclature towards the goal of tariff equalization, and (6) to oversee and recommend procedures designed at unifying the various customs regulations.<sup>32</sup>

Treaty implementation.--The final section provides that the treaty is to go into effect with three member country signatures and that its provisions are to last for a period of twenty years, renewable every ten years thereafter. Any member country may renounce the treaty with two years notice, specifically, within the two years prior to its natural expiration. The goods listed in schedule B are to have equalized tariffs at the end of the "interim period."<sup>33</sup>

#### Agreement Establishing the Central American Bank for Economic Integration

Next to the Central American Trade Organization, the most important organization created under the Central American Common Market is the Bank for Economic Integration created by a separate treaty, which will be discussed below.

Duties.--The bank is to be located at Tegucigalpa, Honduras, and is primarily designed to ". . .meet the needs of the following investment sectors . . .": (1) Any project designed to counterbalance disparities in economic development as found among the member countries; (2) any long-term project that will provide more goods for internal trade within the market or goods designed for export to outside nations; (3) any agricultural project aimed at increasing the efficiency of the Central American farm; (4) any pro-

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<sup>32</sup>Ibid., Articles 12, 13 and 14.

<sup>33</sup>Ibid., Articles 15 and 16.



ject that provides for modernizing or expanding existing industries with an improved competitive position in mind; (5) any project that will provide services necessary to the success of the Common Market; (6) any other project designed to further the union of and trade expansion of the countries of the market.<sup>34</sup>

Financing.--The method of financing the bank's operations and the capital sources that are to be employed are as follows: The original resources are to be equal to sixteen million United States dollars or their equivalent, with A) one million dollars to be immediately receivable from each member country, B) another million dollars to be donated within sixteen months after the bank is organized, and C) the balance to be donated upon the request of the bank at any time that it is deemed necessary. In return for the resources, each member country receives stock certificates which are not transferable, nor are they income producing. Each member country is then allowed to send one delegate to participate on the board of governors, each having voting power in accordance with the ownership shares purchased by the government. The bank may then receive income from the issuance of securities and from any interest on loans, which is to go into a reserve fund for future operations. Finally, the bank's resources are to be valued in accordance with the United States dollar at all times.<sup>35</sup>

Organization, operation and administration.--In this paper, the organization and administration aspects will be discussed first. In the treaty itself, the operation requirements are discussed first.

<sup>34</sup> Agreement Establishing the Central American Bank for Economic Integration, Managua, December 13, 1960, Article 2.

<sup>35</sup> Ibid., Article 4.



The bank will be directed by a Board of Governors, a Board of Directors, and a President. These organizations are to appoint any other official or employee that is necessary to the efficient operation of the bank. Each country will contribute two members to the Board of Governors, one of which will be the minister of economics of the member country. The other will be the president of the central bank of the contributing country. This board will elect its president from the delegation who will serve a term of one official meeting of the board. This board is to have the supreme authority over the activities of the bank, with the option of delegating its powers to the Board of Directors in the course of daily operations. Certain powers, however, are granted only to the Board of Governors and may not be delegated. These include such responsibilities as capital management and certain organizational or procedural decisions.

The Board of Directors is to be a permanent organization with the responsibility of carrying on the daily business of the bank. It will have one member from each participating country, appointed for five-year terms by the Board of Governors, with each member's term of office renewable through regular appointive procedures. This board may convene the Board of Governors any time that a question beyond the scope of the directors' powers presents itself. The Board of Governors is to meet only once a year if no such problem arises. The Board of Directors will answer only to the Board of Governors and will refrain from any political participation within their respective countries. They will elect a president and appoint a vice president of the bank, the president having an equal vote and two votes in the event of a tie. The vice president is to attend all board meetings, but will have no voting rights. The board will appoint all other staff members that are to work in

the bank. This board will have any further powers granted to it by the Board of Governors.

Under these administration entities, the bank is given ten expressed duties, briefly outlined here: (1) To study all investment possibilities that will aid in the fulfillment of the basic objectives as listed in the preceding section on this treaty; (2) to make long and medium-term loans; (3) to issue bonds in its own name; (4) to issue and place any credit instrument that will aid in the discharge of its duties; (5) to obtain loans, credits, and guarantees from member governments as well as from foreign governments; (6) to aid in the securing of loans for government institutions and established enterprises of the member states from other financial institutions or governments; (7) to guarantee loans to governments and established institutions; (8) to obtain guarantees from member governments in securing loans from other financial institutions; (9) to act in an advisory capacity for member states and their industries; (10) to conduct any other business in accordance with the fulfillment of its duties.<sup>36</sup>

Operating procedures.--These sections deal with general operating procedures, and status of the bank within the Common Market framework.

In the first place, any dispute that may come up is to be submitted to the Board of Directors of the bank. The directors, plus representatives of the complaining party, meet and decide the individual case. At this time the bank may act as if the decision were final, but the complaining party may appeal the dispute to the Board of Governors if it is not satisfied with the decision. The Board of Governors' decision is the final and binding one on all parties.

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<sup>36</sup>Ibid., Articles 17 through 26.

Secondly, the bank, its directors, and its employees are to enjoy all privileges and immunities granted to diplomatic personnel. Included in this provision is total exemption from all taxes, duties, or quotas for the bank, its loans, and its employees and their salaries.<sup>37</sup>

Finally, the treaty is to become effective after ratification by three countries and is to be effective for an indeterminate length of time. Any other Central American nation that desires to join the bank may do so by simply signing the treaty. Any member wishing to pull out of the agreement may do so after the bank has been operating for a period of twenty years by giving five years notice. All of the requirements for capital contributions, etc., are still binding against the member countries for the entire life of the treaty. The bank may be completely dissolved only by the unanimous vote of all member countries, at which time the bank's assets will be divided as determined by the Board of Governors.

#### General Treaty on Central American Economic Integration

In 1960 three countries, Guatemala, El Salvador, and Honduras became discouraged with the slow progress being made by the integration program initiated within the council of the United Nations. They decided to get together and draw up a newer, more potent treaty with a quicker, more efficient Common Market as the goal. Many of the provisions of this treaty are repeated sentiments of the Multilateral Treaty. There are important contradictions, however, and the provisions of this treaty are to take precedence over the Multilateral Treaty in these cases.

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<sup>37</sup>Ibid., Articles 27 through 33.

Costa Rica, through the influence of its powerful business class which was afraid of competition from the other members, has refused to sign this treaty, and therefore, only Guatemala, El Salvador, Honduras, and Nicaragua are members of this newer organization. Costa Rica is still expected to join, so specific provision for her signature has been included in this treaty.

With these introductory remarks in mind, we may now look at the treaty itself. Throughout this section, only the points of departure with the Multilateral Treaty will be examined. Unless otherwise stated, the provisions in the Multilateral Treaty not mentioned here are still binding on the five member nations.

Goals.--Unlike the Multilateral Treaty, the goal of tariff elimination in Annex A and tariff reduction and equalization in Annex B are to be completed within a five-year period. This includes tariff equalization against the outside world as stated in the Central American Agreement on the Equalization of Import Duties and Charges.<sup>38</sup>

Free trade.--This rather important section of the treaty restates the provision that all goods will be traded free immediately, with the exception of those listed in Annex A, and these exceptions will be traded free within five years unless exempted by special negotiations between the countries. Articles imported from outside countries are subject to import duties, even if they pass through another member's shores.

Taxes on consumption, production, etc., are to be permitted if they do not restrain trade or take the form of a tariff. By this provision, goods are to be traded on a freely competitive basis with no government inter-

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<sup>38</sup> General Treaty on Central American Economic Integration, Managua, December 13, 1960, Articles 1 and 2.

ference. As far as state monopolies are concerned, they will be permitted to continue their operations if the monopoly was in existence at the time of the signing of the treaty. Any new monopolies are to be prohibited, unless approved by special negotiations between the member states.<sup>39</sup>

Competition.--The states are to allow the price mechanism, working under free competition, to determine the value of imported and exported products as far as is possible. No treaties concerning trade may be made with outside countries if the negotiations are not in accordance with the goals of the Common Market. If there is suspicion of unfair trade practices being conducted by a member country, or an industry within a member country, the executive council (see below) is to be consulted and a decision will be made. This decision is considered as being final and binding in all disputes of this nature.<sup>40</sup>

Transit privileges.--This section provides for free transit between member countries and national treatment for all member country citizens transacting legitimate business within another member country.<sup>41</sup>

Executive Council.--The treaty provides for the Secretariate, as provided for in the Multilateral Treaty, and for an Executive Council, ". . . consisting of one titular official and one alternate appointed by each contracting country . . .", which is to take over the executive duties of the Common Market. Also, a Central American Economic Council is to be established to oversee the integration progress and to act in an advisory capacity to the

<sup>39</sup> Ibid., Articles 3 through 8.

<sup>40</sup> Ibid., Articles 9 through 14.

<sup>41</sup> Ibid., Articles 15, 16 and 17.

Executive Council. Final decisions on all disputes are referred to, and decided by, the Executive Council.<sup>42</sup>

The remainder of the treaty is as established by the Multilateral Treaty with a few minor exceptions.

### Conclusions

Discussing treaties, such as the five above, soon becomes a slow process for both the writer and the reader. Their importance towards the establishment of any intelligent discussion on the Common Market cannot be emphasized too strongly, and for this reason, they have been included as a major portion of this report. Herein lies the essence of the integration program, its organization, its goals, and its method of reaching these goals.

We may now go on to study the possibilities of success or failure for the Common Market. These probability statements will be based on the sections preceding this one as well as this discussion of the treaties.

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<sup>42</sup>Ibid., Articles 20 through 24.

## CONCLUSION

Economic development has long been the goal of the now integrated countries in the Central American Common Market as well as the other underdeveloped regions of the world. This was probably the primary motivation in establishing the market, and any discussion of success or failure should be stated in terms of this ideal. This final section will briefly discuss development as it pertains to Central America and the role that integration is expected to play in this respect. In approaching the problem in this way, some clues as to the success or failure of the market will be given.

### Why Integration?

According to Sidney Dell in his book Trade Blocks and Common Markets, the primary reason behind integration attempts as an answer to developmental problems in "distressed areas" has been the lack of success in approaching the problem as separate economic units. Most countries that are presently experiencing underdevelopment depend on agriculture for their foreign exchange from the world market. Agricultural products, in turn, have long experienced irregular markets in developed areas, or at least markets that do not expand as much as world income expands. At the same time, demand for imports from industrial areas expands greatly with any increase in income, and serious balance of payment problems soon develop. It would seem then, that industrial expansion would be the answer to the development problem in these areas, but many factors have worked against this possibility.



In the first place, industrial expansion means that capital equipment must be imported from abroad. In a country that is already experiencing balance of payments difficulties, this added loss of exchange may prove to be disastrous. If agriculture does not bring in the foreign exchange for normal imports of goods and services, then it should not be expected to bring in enough for capital expansion.

Secondly, when industries are established in underdeveloped countries, they often depend on foreign markets to absorb their output since the domestic market is usually too small to support any sizable output. These foreign markets are usually developed markets since the underdeveloped nation has little chance of overcoming the efficiency barrier imposed by larger countries when dealing with other underdeveloped nations. The developed nations usually respond to this new industry by imposing restrictive barriers against imports in order to protect home industries. With no market for its exports, the underdeveloped nation often slides into a more unfavorable foreign exchange problem than it was in prior to capital expansion.

Finally, the lack of skilled management or labor oftentimes dooms the new industry to a relatively inefficient position with respect to the rest of the world, and competition may restrict exports even without restrictive tariff policies by more developed nations.

Integration may solve these problems in three ways: (1) Provide more foreign exchange through internal trade; (2) improve the relative bargaining position of the various underdeveloped areas, and (3) provide a larger internal market for industrial goods, thereby allowing industrial expansion based on something other than foreign trade. Of the three, the better bargaining position argument carries the most weight in explaining



integration for development in a hostile world. The foreign exchange argument carries more weight when further development after the initial impact is over, and the internal market argument for industry expansion using existing facilities.

### Success or Failure

Any prediction of success or failure is subject to countless qualifications as many variables will be overlooked or ignored. With this in mind, the discussion to follow will concentrate on general observations and conclusions.

Most economic theory that deals with foreign trade will use a set of restrictive assumptions to arrive at the conclusion that free trade is better than restricted trade with the possible exception of the "infant industry argument." Sidney Dell feels that this is probably the case when trade is taking place among countries of equal size economically, but when discussing the problem of underdevelopment, new variables need to enter the discussion.

In the first place, the discussion of free trade needs take underemployment into consideration. Under the classical argument, two nations experiencing a condition of full employment may be made better off by specializing in that commodity which affords them a competitive advantage. But when dealing with an underdeveloped nation, many factors that could be usefully employed are lying idle. If these factors could be put into production, even inefficient production, the national income of that country may be expected to rise. It may then be to the nation's advantage to offer any inducement available to encourage industrialization in order to increase employment. This inducement may be in the form of a tariff wall, subsidies, an expanded

market through integration, or a combination of the three. In the Central American case, we may expect a certain amount of success if any employment is offered to otherwise idle resources as a result of integration.

In the second place, integration success or failure depends a great deal on the willingness of the sovereign powers to give up a measure of their economic control for the good of the whole. With the current rise of a nationalistic spirit in the countries of Central America this may prove to be the barrier to complete success. None of the countries have entered into the agreements without a great deal of hedging in the form of loopholes mentioned previously. Costa Rica has not yet signed all of the treaties, further demonstrating the hesitancy that prevails throughout the area.

This is closely linked with the idea of government stability. Any agreement that has as an objective the creation of new capital or the expansion of old resources must depend on a stable government structure for success. Latin America in general and Central America in particular have not demonstrated even the possibility of stability. This is probably due to the poverty that has long characterized the area along with the inequality of income distribution among the people of the area. These two factors have led to discontent and revolution throughout the history of underdeveloped nations. In this respect then, we may expect much of the success of integration to be in constant danger of failure.

Finally, the attitude that may be taken by the developed areas of the world may greatly influence the success of a integration attempt by Central America. Particularly, the attitude demonstrated by the United States should play a heavy role in determining the outcome of this approach to economic problems. All indications show a favorable attitude as of now, and this may

be expected to continue as long as the current idea of aid is fostered in this country.

These are but a few of the factors that influence the outcome of the Central American Common Market, but they are important ones. If development is advanced at an increased rate, no matter how small, the attempt will have to be called successful, and using this as the basis, the Common Market should be beneficial to the countries involved.

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THE CENTRAL AMERICAN COMMON MARKET

by

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The Central American countries of Nicaragua, Costa Rica, El Salvador, Honduras and Guatemala have entered into a series of agreements forming a Common Market designed to increase trade, and hopefully, capital accumulation. Since all of these countries are underdeveloped, the underlying goal of this integration attempt is economic growth and higher income for the citizens.

The aforementioned growth is to be accomplished with increased trade allowing efficiency of scale with existing capital, and increased investment to accommodate the larger market. There are certain problems that offset some of these expected gains, however, in that the combined markets of Central America may still be too small to support the level of growth contemplated plus the fact that the present economy centers around agriculture, which is generally inefficient and low in worker productivity.

Five treaties stand out as the primary documents of organization:

1. The Multilateral Treaty on Free Trade and Central American Integration which outlines the general objectives and structure of the Common Market. This treaty outlined the schedule to be followed in reducing tariffs between the member countries as well as the schedule for imposing uniform tariffs against the rest of the world. The general goals of free competition, free transit between countries of all traded commodities, and investment arrangements were also included in this treaty. Finally, the Central American Trade Commission was organized to oversee the operation of the Market.

2. Agreement on the Regime for Central American Integration Industries which outlines a scheme for favoring certain industries in order to promote investment. This treaty was designed to (a) establish a favorable climate for certain industries to enter the market, (b) promote the most efficient alloca-

tion of natural resources, and (c) insure that industrial investment takes place at an even rate in all countries.

3. Central American Agreement on the Equalization of Import Duties and Charges which is the specific agreement establishing the rates to be charged against the outside world. It establishes the method of renegotiating disputed rates and for including products that are not expressly listed in the annex to the treaty.

4. Agreement Establishing the Central American Bank for Economic Integration which establishes a central banking authority which is to oversee the financial operations of the Common Market. It is to coordinate the central banking policies of the individual countries, see that there is enough foreign exchange to handle the increased trade between members, sit in on financial disputes between countries, and to make loans in certain circumstances. It is to be run by a board of governors and a board of directors, the former meeting once a year or whenever deemed necessary, the latter to run the daily operations of the bank. Finally, the bank is to receive certain privileges when dealing with the countries such as tax concessions, diplomatic immunity, and free inspection of member countries' financial affairs whenever deemed necessary.

5. General Treaty on Central American Economic Integration which is the final treaty to be discussed. It follows closely the goals and procedures of the Multilateral Treaty with two important exceptions: (A) It moves the time required for tariff elimination and equalization up by five years, i.e., its provisions are to be fully enacted within a five-year period, and (B) the executive council is established as the coordinating board for the Common Market's implementation.



Integration was the method used to accomplish the major goal of growth for the simple reason that all previous attempts were doomed to failure, partly because the developed areas of the world have blocked many attempts to increase trade in manufactured goods, partly because agricultural products represent the major exports of the area and traditionally bring in a disproportionate return when world income is rising, and partly because the individual markets were too small to allow investment to reach an efficient scale. It is hoped that this new approach will overcome these difficulties of underdevelopment.